

**Before the
Federal Communications Commission
Washington, DC 20554**

In the Matter of)	
)	
Sandwich Isles Communications, Inc.)	WC Docket No. 09-133
Petition for Declaratory Ruling)	

**COMMENTS OF NATIONAL EXCHANGE CARRIER ASSOCIATION
ON REFRESH PUBLIC NOTICE**

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SUMMARY

The National Exchange Carrier Association, Inc. (“NECA”) files these comments to refresh the record in this proceeding. The record is complete and is ready for decision. A number of issues have been raised during the course of this proceeding, which are now in the record and ripe for action. NECA requests that the Commission act promptly to resolve this proceeding. Although preservation of service to the subscribers of a rural rate-of-return carrier is critical, such accommodation is possible without excessive network investment.

The FCC established NECA to administer the FCC's interstate access charge system, including special access services. The FCC established the NECA pooling mechanisms in order to average some access charge rate elements among companies, but allow individual companies to recover their own costs from the pool. Because these pools are a “zero sum” proposition, if one company recovers too much money from the pool, other companies, and ultimately their ratepayers, have to pay the difference. The Commission carefully evaluates whether NECA rates are just and reasonable. NECA therefore depends on, and contractually obligates, its member companies to accurately report financial and demand data with respect to their operations, and to maintain the accuracy of such data.

The Paniolo cable system is owned by Paniolo Cable, which is closely related to Waimana Enterprises, SIC’s parent. That cable system connects SIC’s network facilities on various Hawaiian Islands. SIC became the exclusive lessee of the entire Paniolo Cable system. NECA disallowed the Paniolo cable system expenses from SIC’s traffic sensitive revenue requirement as not in compliance with the used and useful doctrine. Instead, NECA allowed SIC to include approximately \$1.9 million for such transport services based on its then-current

payments for such services to a third party plus an allowance for reasonable future growth, a decision which SIC disputed.

SIC initially raised this dispute with the FCC in a Petition for Declaratory Ruling, which the Commission, pursuant to delegated authority, in 2010 denied in part and granted in part in the *Declaratory Ruling*. Although the Bureau's *Declaratory Ruling* was unable to conclude based on record facts provided by SIC that the Paniolo cable system lease expenses were justified based on cost and capacity acquired, it permitted that SIC include 50 percent of the disputed expenses in the traffic sensitive pool revenue requirement based on certain equitable factors.

NECA's description of the used and useful doctrine in its original 2009 comments with respect to SIC's Petition remains valid today. The used and useful doctrine is designed to balance the right of a carrier to be compensated for all of its investment used in providing service to the public with the right of ratepayers to not pay returns on property that cannot be shown to benefit them within a reasonable period of time. There are three prongs to the used and useful standard: (1) the need to compensate the investor for capital devoted to serving the public; (2) the need to charge the ratepayer for only those investments which benefits him; and (3) and a requirement that such benefit be either immediate or coming within a reasonable future period of time. Thus, imprudent or excess investment is the responsibility of the investor, not the ratepayer.

NECA's decision to exclude SIC's new cable lease costs from the NECA pools and the June 2009 annual tariff filing were made based on then-current facts. The record of this proceeding contains no new facts after the year 2010 that would illuminate the current use of the Paniolo cable system. NECA has requested that SIC provide it with updated facts pertaining to a used and useful analysis, but SIC has not done so.

NECA continues to believe that SIC's original estimate of 20,000 homes in its service area of the Hawaiian Home Lands is not realistic, and in any event, the entire capacity of the Paniolo lease is far in excess of what is required to serve even that inflated estimate of potential future subscribers. Given the lack of data, and based on SIC's current Digital Subscriber Line ("DSL") line figures in NECA's possession, NECA has no basis to change its previous conclusion that the Paniolo cable system lease costs are not used and useful. Therefore, NECA believes that based on current facts, SIC has not met its burden of demonstrating that its costs are reasonable, which burden always rests on the carrier seeking to justify its costs for inclusion in tariffed rates. This determination is based on the facts that (1) the cost of the lease is excessive for the number of potential subscribers, and (2) the capacity purchased by SIC is grossly excessive for actual and reasonably expected demand. NECA expresses no view on the equitable factors contained in the *Declaratory Ruling*, except that it urges the Commission to reassess its conclusion that the fact that traffic sensitive pool members fund this investment is irrelevant to its decision.

NECA is unable based on current facts to conclude that the SIC lease imposes an actual legal risk to investors given that (1) a closely related company, Paniolo, is the lessor and (2) nonpayment of the Paniolo cable system lease has occurred over many months stretching into years, with an uncertain timeframe for actual payment, if any. NECA thus believes that the Paniolo cable system lease investment does not meet the first prong of the used and useful standard. In addition, the current facts continue to fail to meet the second (benefit to ratepayer) and third (reasonable time) prongs of the used and useful doctrine, just as they did in 2009.

Through its routine review of member company submissions, as well as SIC's independent auditor reports, NECA discovered in late 2014 that SIC was not paying the entire

cost of the Paniolo cable system lease. Therefore, NECA filed a Clarification Petition with the Commission seeking an interpretation of the original *Declaratory Ruling* with respect to the issue of actual lease payments. Specifically, NECA indicated that it believed that the Bureau intended to require NECA to provide the special 50 percent allowance only for actual lease payments made, not accrual accounting expense entries where there was no prospect of actually funding the accounting entries.

NECA believed its position was supported through its understanding of GAAP requirements, which only permit accrual of expenses if they are actually paid during the normal business cycle, and based on FCC rules and precedent. This Clarification Petition record is complete and ripe for decision. NECA pool members (and thus their respective ratepayers for special access services, including broadband) continue to fund SIC's accounting entries, which are not necessary to compensate investors to the extent that they are not actually paying Paniolo cable system lease costs.

NECA's legal position continues to be that, based both on the facts that existed prior to the *Declaratory Ruling*, and today, the cost and the capacity of the Paniolo cable system are far in excess of what is reasonably required to serve SIC broadband customers from 2010 through the near future. Although NECA does not take any position on the equitable factors adopted in the Bureau's *Declaratory Ruling*, the application of the equitable factors should be reconsidered in light of the actual facts that have taken place since the *Ruling* was issued, including SIC's current provision of DSL service and its failure to actually pay the entire Paniolo system lease costs. NECA urges the Commission to promptly resolve not only the pending challenges to the *Declaratory Ruling*, but also NECA's Clarification Petition.

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**COMMENTS OF NATIONAL EXCHANGE CARRIER ASSOCIATION ON REFRESH
PUBLIC NOTICE**

The National Exchange Carrier Association, Inc. (“NECA”) files these comments pursuant to the public notice requesting that the record in the above-captioned proceeding be updated.¹ The record is complete and is ready for decision. Since the Wireline Competition Bureau of the Commission originally partially granted a declaratory ruling petition filed by Sandwich Isles Communications, Inc. (“SIC”) in 2010, a number of issues have been raised which are now in the record and ripe for action.

NECA urges the Commission to reach a prompt decision on all matters pending in the record to (1) ensure compliance with FCC regulations and orders and (2) preserve equal treatment of carriers participating in the NECA traffic sensitive pool. Although preservation of service to the subscribers of a rural rate-of-return carrier is critical, such accommodation is possible without excessive network investment. NECA includes in these comments a summary of the currently relevant part of the record for the Commission’s convenience.

¹ Public Notice, *Wireline Competition Bureau Seeks to Refresh Record In WC Docket No. 09-133 and Seeks Comment on AT&T Application for Review, Sandwich Isles Petition for Reconsideration, and NECA Petition for Clarification and/or Declaratory Ruling*, WC Docket No. 09-133, DA 16-322 (rel. Mar. 29, 2016).

I. BACKGROUND

A. NECA's Role in Administering Access Rates

The FCC established NECA to administer the FCC's interstate access charge system, including special access services.² The FCC established the NECA pooling mechanisms in order to average some access charge rate elements among companies, but allow individual companies to recover their own costs from the pool.³ Because these pools are a “zero sum” proposition, if one company recovers too much money from the pool, other companies, and ultimately their ratepayers, have to pay the difference.

Pursuant to FCC rules and regulations, NECA collects cost, demand, and revenue data from its member companies and files an annual tariff with the FCC, setting out the interstate access rates that will be charged to access customers. FCC rules require cost member companies to submit cost, demand, and access revenue data to NECA, 47 C.F.R. § 69.605(a), and certify that “the data have been examined and reviewed and are complete, accurate, and consistent with the rules of the Federal Communications Commission.” *Id.*, § 69.601(c).

The FCC closely regulates the way in which member companies maintain and report their individual data. FCC rules require that rate-of-return carriers justify their proposed rates.⁴ Before a NECA tariff goes into effect, the FCC reviews filed rate proposals, supporting documentation, and any opposing petitions. As the FCC explained in a 2004 review, the Commission has a duty to evaluate whether NECA rates are just and reasonable:

² *MTS and WATS Market-Structure*, Third Report & Order, FCC Docket No. 78-72, Phase I, 93 FCC 2d 241, ¶¶ 339, *et seq.* (1983)(“*Access Third Report & Order*”).

³ *Access Third Report & Order* at ¶ 314.

⁴ 47 U.S.C. § 61.38.

Reliable data are essential to the Commission's ability to conduct tariff review and investigations, ensure just and reasonable rates, and, if necessary, to prescribe rates.⁵

NECA depends on, and contractually obligates, its member companies to accurately report financial and demand data with respect to their operations, and to maintain the accuracy of such data.

NECA strives to administer pool tariffs in a fair and impartial manner consistent with FCC rules. When issues arise NECA attempts to resolve them through amicable negotiations. However, reasonable accommodation of individual pool member requests cannot trump NECA's responsibility to uphold Commission rules and administer the pools fairly for all pool participants.⁶ In accordance with NECA's data review function it routinely evaluates carrier financial and revenue requirement submissions for compliance with FCC rules.

B. Proceeding Background

SIC operates as an incumbent local exchange carrier for purposes of the FCC's access charge and universal service rules in certain portions of the State of Hawaii targeted to serving portions of the Hawaiian Home Lands. SIC provides voice and broadband service to these same customers.⁷ SIC participates in both the NECA common line and traffic sensitive pools.⁸

⁵ *July 1, 2004 Annual Access Charge Tariff Filings*, WC Docket No. 04-372, 19 FCC Rcd. 23877, ¶ 24 (2004) (footnotes omitted) (“*2004 NECA Annual Access Order*”).

⁶ *Id.*

⁷ SIC and/or its affiliates provide other regulated and nonregulated services in the State of Hawaii. SIC is wholly owned by Waimana Enterprises, Inc., whose President, according to State of Hawaii Department of Commerce & Consumer Affairs records, is Albert S.N. Hee. *See* <https://hbe.ehawaii.gov/documents/business.html?fileNumber=70009D1&view=officers> (last viewed Apr. 14, 2016). Hee has previously been the President of SIC at earlier timeframes during this proceeding, although now the CEO is Janeen-Ann Olds, who at one time was General Counsel of Waimana and who has been trustee for each of the ultimate trust beneficiaries of the company, Blue Ivory Hawaii Corporation, which indirectly owns Paniolo Cable.

Paniolo Cable⁹ owns an undersea cable system and associated terrestrial transport network (“Paniolo cable system”), constructed by ClearCom, wholly owned by Waimana Enterprises,¹⁰ connecting SIC’s network facilities on various Hawaiian Islands. SIC became the exclusive lessee of the entire Paniolo Cable system. Because the transmission bandwidth and expenses associated with such facilities appeared to be far in excess of what was used and useful to provide regulated service for SIC’s approximately 2000 subscribers at the time, NECA disallowed the majority of these Paniolo cable system expenses from SIC’s revenue requirement.¹¹ SIC objected to NECA’s disallowance. Instead, NECA allowed SIC to include approximately \$1.9 million for such transport services based on its then-current payments for such services to a third party plus an allowance for reasonable future growth.

⁸ The FCC ordered that NECA include SIC as a pool member in *Sandwich Isles Communications, Inc., Petition for Waiver of Section 36.611 of the Commission’s Rules and Request for Clarification*, Order, 13 FCC Rcd. 2407 (Comm. Carr. Bur. 1998); *GTE Hawaiian Telephone Company, Inc., application for Review of a Decision by the Common Carrier Bureau*, Memorandum Opinion and Order, 19 FCC Rcd. 22268 (2004); *Sandwich Isles Communications, Inc., Petition for Waiver of the Definition of “Study Area” Contained in Part 36, Appendix-Glossary and Sections 36.611 and 69.2(hh) of the Commission’s Rules*, Order, 20 FCC Rcd. 8999 (Wir. Comp. Bur. 2004), *app. for. rev. pending*.

⁹ To the best of NECA’s knowledge, the Paniolo Cable Company (owner of the leased cable) remains indirectly owned in its entirety by Blue Ivory Hawaii Corporation, which is held by the children of Albert S.N. Hee, in “three private trusts, the Adrienne H.R. Hee Irrevocable Trust, the Breanne E.R. Hee Irrevocable Trust, and the Charlton E.R. Hee Irrevocable Trust. Each trust holds shares of Blue Ivory Hawaii for the benefit of the named beneficiary.” Public Notice, *Actions Taken Under Cable Landing License Act*, DA 09-998 (May 4, 2009). These relationships are more fully disclosed in Comments of the National Exchange Carrier Association, Inc. (NECA), WC Docket No. 09-133 (filed Aug. 31, 2009) (“NECA PDR Comments”).

¹⁰ Brandon Roberts, ClearCom Not So Clear, *Molokai Dispatch* (Jan. 24, 2008).

¹¹ It is unnecessary at this point to recount the entire procedural history related to inclusion or noninclusion of the Paniolo cable system lease costs in SIC’s revenue requirement, which is described in more detail in NECA PDR Comments, as well as in the *Sandwich Isles Communications, Inc.*, 25 FCC Rcd. 13647, ¶¶ 2-8 (Wir. Comp. Bur. 2010), *pet. for recon. and app. for rev. pending* (“*Declaratory Ruling*” or “*Ruling*”).

SIC initially raised this dispute with the FCC in a Petition for Declaratory Ruling, which the Commission, pursuant to delegated authority, eventually denied in part and granted in part in the *Declaratory Ruling*.¹² The Wireline Competition Bureau found that NECA had acted properly in its handling of the matter, and that only the Commission could grant the relief adopted in the *Ruling*.¹³ Although the *Declaratory Ruling* was unable to conclude based on record facts provided by SIC that the Paniolo cable system expenses submitted were justified based on cost and capacity acquired¹⁴ it permitted a portion of the expenses based on certain equitable factors, including SIC's role in serving the Hawaiian Home Lands, the rural and insular nature of its service territory, the need to compensate SIC for its investment in infrastructure, and the need for the capacity, including some allowance for spare capacity.¹⁵ The FCC required "NECA to recognize 50 percent of Sandwich Isles' Paniolo cable network lease expenses subject to dispute in its revenue requirement for ratemaking purposes."¹⁶ NECA has implemented this *Ruling* in accordance with its understanding of the *Ruling's* terms.¹⁷

¹² *Declaratory Ruling* at ¶ 9.

¹³ *Id.* at ¶¶ 9, 18.

¹⁴ Specifically, the Bureau cast serious doubt on SIC's demand estimates, its alleged need for the entire capacity of the cable, and the reasonableness of the costs of leasing the Paniolo cable system. *Id.* at ¶¶ 22- 23.

¹⁵ *Id.* at ¶¶ 19-21.

¹⁶ *Id.* at ¶ 29. The *Declaratory Ruling* specifically provides: "The lease expenses subject to dispute would include the costs for SIC to lease the Paniolo cable network each year, including the maintenance and insurance costs SIC is responsible for under the terms of the lease agreement, to the extent that they are not attributable to actual usage of the cable." *Id.* at ¶ 9 n.30. The "disputed expenses" also include "certain engineering costs" but exclude "expenses related to the actual usage of the Paniolo cable network for the provision of services covered by the NECA tariff" and "to provide services not encompassed by the NECA tariff, including, among other things non-regulated services and intrastate services." *Id.*

¹⁷ The Bureau raised questions about the propriety of the Paniolo cable system expenses in another context. *Connect America Fund, Sandwich Isles Communications, Inc. Petition for*

SIC filed a petition for reconsideration of the *Declaratory Ruling*.¹⁸ Therein, SIC argued for the first time that NECA failed to consider one of its guideline papers related to the accounting treatment of spare fiber cable and wire facilities¹⁹ in its determination that only a portion of SIC's submarine and related investment should be allowed in the rate base. In particular, SIC argued that this determination was inconsistent with NECA's guidelines identifying the separations treatment of spare fibers.²⁰ NECA opposed this petition based on the newly raised argument as a violation of 47 C.F.R. § 1.106(l). In any event, NECA believed that SIC's argument misconstrued NECA's spare fiber guidelines, but which were superseded in any event by the *Declaratory Ruling* with respect to the facts in this case.²¹

AT&T filed an application for review of the *Declaratory Ruling*, arguing that the Bureau misapplied the used and useful doctrine.²² AT&T argued that SIC did not demonstrate the reasonableness of the cost of the Paniolo cable system lease or the need for the capacity purchased by the lease. AT&T also argued that the *Declaratory Ruling*'s analysis of equitable factors was erroneous, inconsistent with used and useful legal precedent, and should be reversed. NECA took no position on AT&T's application for review.

Waiver of Section 54.302 of the Commission's Rules, WC Docket No. 10-90, 28 FCC Rcd. 6552, ¶ 19 (Wir. Comp. Bur. 2013).

¹⁸ Sandwich Isles Communications, Inc. Petition for Reconsideration, WC Docket No. 09-133 (filed Oct. 29, 2010) ("SIC PFR").

¹⁹ *Id.*, Exhibit A (Harper Declaration), Exhibit A ("Spare Fiber C&WF Investment, Cost Reporting Guidelines").

²⁰ *Id.* at 2.

²¹ Comments of the National Exchange Carrier Association, Inc. (NECA), WC Docket No. 09-133, 2-3 (filed Dec. 6, 2010) ("NECA PFR Comments").

²² Application for Review of AT&T Inc., WC Docket No. 09-133 (dated Oct. 28, 2010).

In 2012, NECA discovered from information provided by SIC that it had leased capacity to a third party on the Paniolo cable system. NECA adjusted SIC's revenue requirement to exclude those third-party lease payments in accordance with the requirements of the *Declaratory Ruling*.²³ SIC challenged this NECA action at the FCC, which challenge was dismissed by the Bureau,²⁴ and is no longer pending before the Commission. NECA has no additional information whether SIC has attempted to lease excess capacity to third parties on the Paniolo cable system, or whether it has in fact done so.

Through its routine review of member company submissions, as well as SIC's independent auditor reports, NECA discovered in late 2014 that SIC was not paying the entire cost of the Paniolo cable system lease.²⁵ Therefore, on February 6, 2015, NECA filed a Clarification Petition with the Commission seeking an interpretation of the original *Declaratory Ruling* with respect to the issue of actual lease payments.²⁶ Specifically, NECA indicated that it believed that the Bureau intended to require NECA to provide the special 50 percent allowance only for actual lease payments made, not accrual accounting expense entries where there was no prospect of actually funding the accounting entries. Comments with respect to the NECA Petition for Clarification were solicited and received. While SIC argued that its revenue requirement treatment of the Paniolo cable system lease expenses was proper, it offered no

²³ *Declaratory Ruling*, ¶ 9 n.30.

²⁴ *Sandwich Isles Communications Inc., Petition for Declaratory Ruling*, WC Docket No. 09-133, 27 FCC Rcd. 470 (Wir. Comp. Bur. 2012).

²⁵ The Paniolo cable system provides capacity for multiple services, which are part of NECA's traffic sensitive pool. As a net taker, SIC receives money from this pool based on its submitted costs. Inclusion of the "disputed lease expenses" impacts certain overhead allocations, and therefore also has some minimal impact on common line revenue requirement.

²⁶ National Exchange Carrier Association, Inc., *Petition for Clarification and/or Declaratory Ruling*, WC Docket No. 09-133 (filed Feb. 6, 2015) ("NECA Clarification Petition").

explanation of nonpayment of the lease or prediction when such payment would be made.²⁷

Based on the payment of management fees to SIC's parents and the conviction of Albert Hee's for criminal tax fraud, the Universal Service Administrative Corporation ("USAC") suspended universal service payments pending an audit of SIC USAC submissions.²⁸ NECA is unaware of the results of that audit, or even whether it is complete at this time.

II. THE USED AND USEFUL NATURE OF THE PANIOLO CABLE SYSTEM LEASE.

A. Used and Useful Legal Test.

NECA's description of the used and useful doctrine in its PDR Comments remains valid today, which is reproduced and updated in these comments. The used and useful doctrine is designed to balance the right of a carrier to be compensated for all of its investment dedicated to the use of providing service to the public with the right of ratepayers to not pay returns on property that cannot be shown to benefit them within a reasonable period of time.²⁹ There are three prongs to the used and useful standard: (1) the need to compensate the investor for capital devoted to serving the public; (2) the need to charge the ratepayer for only those investments which benefits him; and (3) and a requirement that such benefit be either immediate or coming

²⁷ Sandwich Isles Communications Opposition to NECA Petition for Declaratory Ruling, WC Docket No. 09-133, at ii (dated Mar. 12, 2015) ("SIC Opposition").

²⁸ Sandwich Isles Communications, Inc., Emergency Petition for Review, CC Docket No. 96-45, WC Docket No. 09-133, and WC Docket No. 10-90, 2-3 (filed Dec. 3, 2015).

²⁹ *American Tel. & and Tel. Co., Phase II Final Decision & Order*, 64 FCC 2d 1 (1977) ("*Docket 19129 Phase II*").

within a reasonable future period of time.³⁰ Thus, imprudent or excess investment, for example, is the “responsibility and coincident burden of the investor, not the ratepayer.”³¹

The third prong of the doctrine is included to protect ratepayers from being forced to pay a return on investment which may not be used for a considerable length of time or is not needed to serve as a reserve for currently used investment.³² Accordingly, the Commission concluded that it was duty bound to disallow inclusion of investment from the rate base that is not necessary to insure the utility has a reasonable capability to serve the ratepayers with efficient service on a continuous basis.³³ In other words, ratepayers are not required to pay rates today that recover costs for equipment that will not be used for years to come, if at all.

While the used and useful standard prohibits the inclusion of the cost of plant in the rate base unless the plant is in operation and is providing direct benefits to subscribers, excess capacity (plant that has been built but is not currently used and useful) is a related concept that

³⁰ *Id.*

³¹ *Id.*, at ¶ 112. *See also, Philadelphia Elec. Co. v. Pennsylvania Pub. Util. Comm.*, 433 A.2d 620 (Pa. Cmwlth. 1981) (holding that prudently made investments in operating plant can be lawfully excluded from a utility’s rate base when those investments are not used and useful for the provision of service to the public); *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989) (upholding Pennsylvania’s scheme of utility regulation against a claim of unauthorized taking of private property simply because it disallowed recovery of capital investments that are not used and useful in service to the public when the utilities overall return on investment was reasonable).

³² *Id.* at ¶ 113.

³³ *Id.* In 1987, the FCC adopted a rule (47 C.F.R. § 32.2002) requiring that property purchased and held for future use be placed into service within two years of its acquisition to be included in the rate base. *See, Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers*, Report & Order, 2 FCC Rcd. 269 (1987), *recon.* 4 FCC Rcd. 1697 (1987), *aff’d*, *Illinois Bell Tel. Co. v. FCC*, 911 F.2d 776 (D.C. Cir. 1990).

must also be considered.³⁴ The Commission has defined two types of excess capacity.³⁵ First, where plant is being used but not to its full capacity, the portion of the plant not in use is considered excess capacity. Second, excess capacity can be fully constructed plant not being used at all. The operator may include plant that is considered excess capacity in its rate base only to the extent it intends to place the plant into service within a reasonable amount of time.³⁶ The most recent Commission rulings on used and useful involve cable TV rates. However, the cable-related decisions are themselves based on traditional utility regulation. In the mid 1990's, the FCC addressed rate regulation of the cable TV industry and the FCC's intention to apply the telephone used and useful standard to cable TV rates.³⁷ The FCC noted that telephone regulations provide for a limited amount of excess capacity and there is an opportunity annually

³⁴ *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*. CS Docket No. 94-28, *Second Report and Order, First Order on Reconsideration, and Further Notice of Proposed Rulemaking*, 11 FCC Rcd. 2220, at ¶ 31 (1996). See also, *Cox Communications San Diego, Inc.; Appeal from a Local Rate Order of the City of Chula Vista, California, Memorandum Opinion & Order*, 13 FCC Rcd. 17653 (1999); *MCI Telecomm. Corp. v. American Tel. & Tel. Co., Memorandum Opinion & Order*, 74 FCC 2d 184, at ¶ 24 (1979) (“[C]arriers have an obligation to avoid overexpansion of plant which leads to an excessive rate base.”).

³⁵ *Id.* at 36.

³⁶ The Commission also discussed the difference between “excess capacity” and reasonable “spare capacity” in *Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs, Tenth Report & Order*, 14 FCC Rcd. 20156, at ¶186 (1999). There, the FCC noted that “network engineers include a certain amount of spare capacity to accommodate administrative functions, such as testing and repair, and some expected amount of growth,” as well as “small increases in demand or [the ability to address] service outages.” *Id.*

³⁷ *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service*, CS Docket 94-28, *Report and Order and Further Notice of Proposed Rulemaking*, 9 FCC Rcd. 4527 (1994), *recon.*, 11 FCC Rcd. 2220 (1996).

to adjust the rate base downward if the excess capacity does not become used and useful within a certain period.³⁸

There are also a number of other orders over the years where the FCC disallowed carriers' investments as being excessive or otherwise not used and useful.³⁹ In the event investments are deemed not used and useful or deemed to have been imprudently incurred in the provision of interstate services, the Commission has reserved the right to disallow the recovery of any or all such expenditures from interstate ratepayers.⁴⁰ Similarly, the FCC has disallowed projected increases in carrier investments in network facilities that exceeded trended industry growth rates, when the carriers were unable to differentiate their situations from those experienced by other carriers.⁴¹

The Commission has also evaluated the issue of plant held for future use, defined as "property purchased [now] taking advantage of cost-saving opportunities . . . where such acquisition in advance of actual use lowers the ultimate cost of service to the ratepayers",

³⁸ *Id.*, referring to 47 C.F.R. § 32.2002 (Plant Held for Future Use).

³⁹ *The Western Union Tel. Co., Initial Decision in Phase I of Docket 78-97*, 95 FCC 2d 924 (1982). The hearing examiner concluded that Western Union "modernized its plant to the point where it has padded its rate base with excess capacity DES investment. *Long-Term Number Portability Tariff Filings, US WEST Communications, Inc.*, CC Docket No. 99-35, *Memorandum Opinion & Order*, 14 FCC Rcd. 11983 (1999); *Annual 1988 Access Tariff Filings, Memorandum Opinion & Order*, 3 FCC Rcd. 1281, at ¶¶ 144-45 (1987).

⁴⁰ *Contel of Virginia, Inc., doing business as GTE Virginia, Order & Authorization*, 10 FCC Rcd. 12672, at ¶117 (1995).

⁴¹ *Annual 1990 Access Tariff Filings*, MM Docket No. 90-320, *Memorandum Opinion & Order*, 5 FCC Rcd. 4177, at ¶¶ 274-91 (Comm. Car. Bur. 1990). Only Lincoln Telephone Company was able to demonstrate that its higher investment projections were tied to a definitive plan to introduce Signaling System 7 (SS7) technology in its single large metro area all at once. Moreover, the facts showed Lincoln's COE Category 3 plant before the SS7 project was undertaken constituted only 25% of the average for all local exchange carriers. *Id.*, at ¶ 290.

concluding two (2) years, subject to specific waiver, is a reasonable time within which Plant Held for Future Use must be employed in telephone service.⁴²

The FCC has also considered the reasonableness of carrier investments by examining the prices paid by carriers for equipment or services used in connection with the provision of interstate services. The leading example is the Commission's scrutiny of Western Electric's prices for equipment sold to AT&T Long Lines Department and the Bell Operating Companies. The FCC concluded the Bell System's purchasing policies required changes to accommodate acquisitions from suppliers other than Western Electric, since that company's prices were often not the lowest. However, the FCC did not make any adjustments to the Bell System's interstate revenue requirements because of its purchases from Western Electric, based on the record of the Commission.⁴³ The FCC has consistently refused to require carriers to produce or procure equipment and services at the lowest possible price. The lowest priced equipment may, for

⁴² *Docket 19129 Phase II*, at ¶¶ 155 through 162; 47 C.F.R. § 32.2002.

⁴³ *Id.*, at ¶¶ 291, *et seq.* See also, *American Telephone and Telegraph Company, The Bell Telephone Company of Pennsylvania, The Chesapeake and Potomac Telephone Company, The Chesapeake and Potomac Telephone Company of Maryland, The Diamond State Telephone Company, New England Telephone and Telegraph Company, New Jersey Bell Telephone and Telegraph Company, New York Telephone Company, and The Southern New England Telephone Company, for authority under Section 214 of the Communications Act of 1934, as Amended, to Supplement Existing Facilities by Construction, Acquisition and Operation of a Lightguide Cable between Cities on a Main Route between Cambridge, Massachusetts and Washington District of Columbia, with Extension Lightguide Cables to Various Cities along this Route*, Memorandum Opinion, Order & Authorization, 89 FCC 2d 1167 (1982). The FCC stated that, in the context of its review of a Section 214 application: "Ensuring the lowest possible rates is an important goal, but it is not our only one. Indeed, there may be more than one approach to achieving this goal in the long run." *Id.*, at ¶ 29. In that same paragraph, the Commission stated its responsibilities as follows: "But, as has been recognized both by this Commission and the courts, our general mandate and, specifically, our mandate under Section 214, calls for consideration of other factors and a balancing of all relevant factors by this Commission in assessing the public interest." *Id.*, citing *Telegraphers Union v. United States*, 87 F. Supp. 324 (D.C.), *aff'd per curiam*, 338 U.S. 864 (1949).

example, have higher maintenance costs or a shorter service life or fail to provide adequate quality service. Notwithstanding this, the FCC has generally examined the totality of the circumstances and accepted or approved carriers' purchase of goods or services that were reasonably priced for the facts of each case.⁴⁴ This is a fair standard for both investors and ratepayers.

The FCC also provided guidance in connection with its policy statements related to facilities for international services, which were subject to various levels of competition between wireline voice, wireline data and satellite services, even as far back as the 1970s.⁴⁵ After noting its policies would be technology neutral, the FCC stated:

In applying and implementing these guidelines to specific situations, we will seek to authorize those facilities which will result in the least cost combination of facilities which is consistent with meeting specified traffic requirements and acceptable service standards.⁴⁶

In another case, the full Commission affirmed the Common Carrier Bureau's disallowance of \$73 million of billing expenses claimed by AT&T where those costs exceeded what AT&T would have been required to pay LECs to perform billing and collection services for them and where AT&T was otherwise unable to justify the reasonableness of the extra expenses.⁴⁷ The FCC confirmed it was not necessary for there to be "bad faith, exorbitant waste,

⁴⁴ *Id.*

⁴⁵ *See, e.g., Policy to be Followed in Future Licensing of Facilities for Overseas Communications, Further Statement of Policy and Guidelines*, 62 FCC 2d 451 (1976).

⁴⁶ *Id.*, at ¶15 (emphasis added). The Commission continued to explain its reasoning as follows: "Where no significant differences arise in the resulting levels of service reliability between alternative means of meeting stated service objectives, consideration of service reliability is not a determining factor in the selection of the least cost combination of facilities." *Id.* at n.2.

⁴⁷ *AT&T Communications Revisions to Tariff F.C.C. Nos. 1, 2, 11, 13, and 14, Application for Review*, CC Docket No. 87-611, *Memorandum Opinion & Order*, 5 FCC Rcd. 5693 (1990). However, because AT&T interstate earnings were more than \$73 million below the earnings

or other exceptional circumstances” upon the part of the carrier to justify a disallowance, but only that the added level of expenses did not provide sufficient benefits to ratepayers. In other orders, the FCC has disallowed expenses that exceeded industry average expenses or averages for similarly situated carriers.⁴⁸

The *Declaratory Ruling* did not cast doubt on any of this cited precedent. Rather, it made its special 50 percent allowance based on certain equitable factors, including (1) SIC’s service to residents of the Hawaiian Home Lands, (2) the cost of serving rural and insular parts of Hawaii, (3) the need to compensate SIC investors for investment in facilities necessary to serve those subscribers, balanced against (4) the anticipated demand for service plus reasonable spare capacity.⁴⁹

ceiling imposed by the FCC, no refunds were required to be made. Nevertheless, the FCC warned AT&T that it would be required to make similar showings in the future or face the possibility of paying refunds to customers in the event that its internal billing expenses continued to be excessive when compared to the cost of competing services from the LECs.

⁴⁸ In evaluating LEC access charges, the Commission adopted two tests to identify potential excessive expenses. The first test “compares the projected percentage change in a cost element [for each LEC] with the industry-wide projected percentage change [for the same cost element].” The second test “compares the absolute level of change, relative to the size of the company, with the average absolute change.” *Annual 1989 Access Tariff Filings, Memorandum Opinion & Order*, 4 FCC Rcd. 3638, at ¶ 110 (1989). Any carrier’s expense for a category that exceeded the average by one standard deviation was flagged. Unless the affected LEC was able to explain satisfactorily the anomaly, the FCC generally reduced the associated expenses to the industry mean. *Id.* at ¶ 112. See also, *Beehive Telephone Company, Inc.*, CC Docket No. 97-237, *Memorandum Opinion & Order*, 13 FCC Rcd. 2736 (1999). In that case, the FCC compared the ratio of Beehive’s operating expenses/telephone plant in service (OE/TPIS) to those of similarly sized rural LECs (based on the number of access lines) for several years. The comparisons showed that, for 1994 and 1995, Beehive’s OE/TPIS ratios were approximately 24 percent and also somewhat higher than average for similarly sized LECs, but for the tariff filing under investigation, Beehive’s OE/TPIS ratio climbed to 59.96 percent. The FCC, after acknowledging Beehive might be a higher cost carrier, disallowed all operating expenses above an OE/TPIS ratio of 25 percent.

⁴⁹ *Declaratory Ruling* at ¶¶ 19-25.

NECA takes no position on the equitable factors utilized by the Bureau in the *Declaratory Ruling*. To the extent that SIC has failed to actually pay the costs of the Paniolo cable system lease, the Commission should reevaluate the Bureau's conclusion that the 50 percent of disputed expenses "allocation provides appropriate recovery for Sandwich Isles investors."⁵⁰ The Bureau's *Declaratory Ruling* did refuse to include in the equitable used and useful calculus consider the fact that the special 50 percent special allowance was funded through pool payments, thus other pool participants and their ratepayers.⁵¹ The Commission should reconsider this Bureau conclusion, including at a minimum, the extent to which lease expenses are not actually paid. If the traffic sensitive pool revenue requirement is improperly inflated, then the cost for service is too high, and probably unreasonable, which would harm rural ratepayers for broadband service.

B. Current Factual Circumstances.

NECA's decision to exclude SIC's new cable lease costs from the NECA pools and the June 2009 annual tariff filing were made based on then-current facts.⁵² The record of this proceeding contains no new facts after the year 2010 that would illuminate the current use of the Paniolo cable system. NECA has requested that SIC provide it with updated facts pertaining to a

⁵⁰ *Declaratory Ruling* at ¶ 25.

⁵¹ *Id.* at ¶ 24.

⁵² NECA did include the then-current costs of SIC's lease of cable facilities from Hawaiian Telcom, in its June 2009 annual filing. SIC had been incurring charges from Hawaiian Telcom to lease cable capacity in order to provide service to SICs' customers. At the time of its original comments, NECA expected that this lease of capacity from Hawaiian Telcom would terminate sometime in 2009. NECA PDR Comments at 3 n.7. NECA does not know whether SIC continues to lease facilities from Hawaiian Telcom, and if so, whether such facilities relate to the lease of the Paniolo cable system.

used and useful analysis, but SIC has not done so.⁵³ The information relied on by NECA in evaluating the used and useful issue prior to 2010, and which the Commission used in issuing the *Declaratory Ruling* was generally limited to (1) the number of voice subscribers currently being served, and which could potentially use DSL-based broadband services of SIC, (2) the potential number of households that would locate in the Hawaiian Home Lands, which could request service from SIC, and (3) the number of fibers in the Paniolo cable system and the system's potential capacity.

The Paniolo cable system lease originally had an annual cost of approximately \$** CNF**, but had a sliding scale that increased from year to year. Currently, the annual cost of the lease is \$** CONFIDENTIAL **, scheduled to rise to \$** CONFIDENTIAL

. ⁵⁴ NECA concluded that SIC had been paying for broadband transport from third parties for about \$CNF** annually, and allowed SIC to include up to \$1.9 million annually in order to address future growth. NECA determined that such compensation was reasonable for the number of potential subscribers, even using SIC's estimate of 20,000 subscribers.⁵⁵

⁵³ NECA counsel sent a letter to SIC counsel on April 4, 2016 requesting, pursuant to Section III.A.1. of the Agreement for the Distribution of Interstate Access Revenues entered into between NECA and SIC, dated April 10, 1998, that such information be provided by April 11 for use in this docket. On April 6, 2016, SIC counsel refused to provide the requested information. NECA has always invited SIC to provide further information which could justify its Paniolo cable system lease costs as used and useful.

⁵⁴ These numbers only reflect actual lease payments and not the additional disputed costs of the Paniolo network that SIC is required to bear for maintenance, engineering, and insurance purposes. *See* note 16, *supra*.

⁵⁵ NECA PDR Comments at 20.

At the time of the *Declaratory Ruling*, SIC, according to data reported to NECA, reported about *** DSL lines in July 2009,⁵⁶ which increased to about **** in January 2016; it currently has **** DSL lines as of March 2016.⁵⁷ Based on the current data available, and SIC's burden of justifying the level of its expenses and investment, NECA's judgment continues to be the same as it was in 2010: the Paniolo lease expenses and capacity are excessive for what is reasonably required to provide regulated service, i.e., is not used and useful.⁵⁸

The original *Declaratory Ruling* cast serious doubt on SIC's number of expected subscribers,⁵⁹ repeating the original goal of the Hawaiian Home Lands ("HHL") that it would build housing for up to 20,000 native residents. That potential construction had not materialized. The Department of Hawaiian Home Lands ("DHHL") had stated their objective is to "Deliver an average of 500 new residential housing opportunities per year in proportion to the number of applicants on the residential waiting list for each island."⁶⁰ "But the 20,000 homes do not yet exist. The number represents the families who are on the Hawaiian Homes waiting list for a new

⁵⁶ *Id.*, Appendix A.

⁵⁷ *See* Appendix A (attached to this pleading).

⁵⁸ *See* note 53, *supra*. For example, and at a minimum, NECA does not have any data concerning the amount of capacity that SIC broadband subscribers currently use, how much such usage reasonably requires of the Paniolo cable system, how much of such usage is served by facilities purchased from third parties, and the realistic expected trends in DSL subscribers in the relatively near future.

⁵⁹ *Declaratory Ruling* at ¶¶ 22-23.

⁶⁰ *See*, Department of Hawaiian Home Lands, General Plan, http://dhhl.hawaii.gov/wp-content/uploads/2012/05/Island_Plan_General_2002.pdf (February 16, 2002) (last visited on Apr. 8, 2016). *See also*, Anthony Sommer, *Fiber Optic Firm Taps Federal Gold Mine*, Honolulu Star-Bulletin, June 4, 2002, available at <http://archives.starbulletin.com/2002/06/04/news/story2.html> (last visited on Apr. 8, 2016).

home. At the current rate of DHHL home construction (about 500 new homes per year), the 20,000 dwellings will not be completed for another 40 years.”⁶¹

More recent information confirms this slow construction progress. The DHHL now states that its goal is to add approximately 170 sites per year, or approximately 3,400 homesteads over the next 20 years. However, it is not meeting this goal. In describing island specific plans for O’ahu, DHHL stated: “Assuming the General Plan goal of 170 homestead awards per year can be achieved, then approximately 25% (3,029 applicants) of O’ahu’s 12,956 applicants can be served within the next 20 years. However, based on the development trends over the last five years, DHHL has not reached the development goal identified in its General Plan. DHHL’s current absorption rate is approximately 70 awards per year. At the current absorption rate, approximately 10% of the O’ahu applicants will be served during the next 20 years.”⁶²

Thirty percent of requested developments by Hawaiian natives are for the Island of O’ahu. “Based on survey responses, just over half of the applications across all islands are for residential lots (50.7%). Among residential applicants, nearly two-thirds would prefer a residential land award on the island of O’ahu (61.9%). The remainder of the residential applications were divided among the counties of Hawai’i (17.7%), Maui (13.8%), and Kaua’i (6.7%).”⁶³ Given that O’ahu residents do not require an inter-island undersea cable to obtain broadband service, further doubt is cast on SIC’s need to lease the entire capacity of the Paniolo

⁶¹ *Id.*

⁶² PBR Hawaii (prepared for DHHL), O’ahu Island Plan, ES-3 (Jul. 2014), *available at* <http://dhhl.hawaii.gov/wp-content/uploads/2013/04/DHHL-OIP-Final-140708.pdf> (last visited Apr. 7, 2016) (“DHHL O’ahu Island Plan”).

⁶³ SMS (prepared for DHHL), DHHL Beneficiaries Study Applicant Survey Report 2014, 6 (Feb. 2015), *available at* <http://dhhl.hawaii.gov/wp-content/uploads/2014/08/150227-DHHL-Applicant-Report.pdf> (last visited Apr. 7, 2016).

cable system lease to serve anticipated demand for broadband service. NECA also believes that a substantial number of customers in the Hawaiian Home Lands continue to receive telecommunications services from Hawaiian Telcom.

Given the available data, NECA has no basis to change its previous conclusion that the Paniolo cable system lease costs are not used and useful. This determination is based on the facts that (1) the cost of the lease is excessive for the number of potential subscribers, and (2) the capacity purchased by SIC is grossly excessive for actual and reasonably expected demand.⁶⁴

C. Application of Used and Useful Test to Current Circumstances.

SIC's 2009 Petition for Declaratory Ruling asked the Commission to rule that the cost of the Paniolo lease for the entire capacity of the Paniolo cable system satisfied the used and useful test. NECA does not dispute that SIC deserves to be compensated at some level in accordance with the first prong of the used and useful doctrine, the right of the investor to be compensated. But this conclusion is based on the extent to which actual investor funds are being expended for such investment. If the investor is not making payments for the investment, prong one is not met. One could argue that a legal obligation to pay, even if it is not actually made, places the investor at risk that it will eventually have to locate funds to meet such obligation. Notwithstanding, NECA is unable based on current facts to conclude that the SIC lease imposes an actual legal risk to investors given that (1) a closely related company, Paniolo, is the lessor and (2) nonpayment has occurred over many months stretching into years, with an uncertain timeframe for actual payment, if any. Therefore, NECA believes that based on current facts, SIC

⁶⁴ As indicated previously, NECA takes no position with respect to the legal basis for the equitable considerations the Bureau used to make its own used and useful determination in the *Declaratory Ruling*, particularly given that it is not NECA's role to make such equitable decisions. *Declaratory Ruling*, ¶ 18.

has not met its burden of demonstrating that its costs are reasonable, which burden always rests on the carrier seeking to justify its costs for inclusion in tariffed rates.⁶⁵

In addition, the current facts continue to fail to meet the second (benefit to ratepayer) and third (reasonable time) prongs of the used and useful doctrine, just as they did in 2009.

In applying the second prong, NECA had and continues to have serious concerns about the scale of this project based on the size of SIC's customer base for regulated services.⁶⁶ SIC has asserted it will have 20,000 subscribers over the life of the lease.⁶⁷ However, it currently serves substantially less than this number and there are significant questions as to if or when 20,000 Hawaiian Home Land dwellings will actually be built and served by SIC.⁶⁸ Excessive investment of this type has previously been disallowed by state utility commission findings.⁶⁹

Under SIC's proposal, today's ratepayers would essentially be paying for a level of service that might never be provided during the length of the lease. Even if SIC reaches its

⁶⁵ See, e.g., 2004 NECA Annual Access Order, ¶ 24; *Beehive Tel. Inc. v. Bell Operating Cos.*, 12 FCC Rcd. 17930, ¶¶ 5, 23 (1997) (carrier has burden of proving rates are just and reasonable in tariff proceedings).

⁶⁶ See NECA PDR Comments, Appendix A.

⁶⁷ *Id.* at 19 n.65.

⁶⁸ See text accompanying notes 57-60, *supra*.

⁶⁹ *State ex rel. Utilities Comm'n v. Mebane Home Tel. Co.*, 242 S.E.2d 165 (N.C. App. 1978), *aff'd*, 257 S.E.2d 623 (N.C. 1979). The North Carolina Utilities Commission found that a telephone company's investment in plant to serve expected new home construction that had not materialized constituted "excessive investment" that was not recoverable in rates. The State Commission disallowed all investment that was based on demand growth in excess of historical patterns. See also, *In Public Service Comm'n v. Montana-Dakota Utilities Co.*, 100 N.W.2d 140 (N.D. 1959), a leading case in which the state supreme court upheld the PSC's disallowance of additional costs to construct a larger capacity natural gas pipeline than was needed to serve existing customers. The court stated, in applicable part: "The anticipated patrons of the company under the present proposal cannot be burdened in order to provide for possible needs of other patrons in other communities sometime in the future." *Id.*, 100 N.W.2d at 150. Accord, *Fern Lake Co. v. Public Service Comm'n*, 357 S.W.2d 701 (Ky. 1962)

maximum estimate of 20,000 customers, there is still the strong likelihood the vast majority of its leased capacity would not be necessary to meet the needs of SIC' customers for regulated services, even given current expected residential subscriber usage.⁷⁰ This highlights concerns that the inclusion of the entire costs of the cable lease represents excess or imprudent investment. Applicable precedent indicates that the FCC is strict concerning investment in excess capacity, and only allows such investment to be included in the rate base if it will be put into service within a reasonable time or constitutes reasonable spare capacity.⁷¹ SIC has not adequately demonstrated a reasonable likelihood that it will place all its leased capacity into service for the benefit of SICs' subscribers using regulated services within such time.⁷² In addition to affecting ratepayers in Hawaii, the inclusion of these costs in the NECA pools would significantly impact both ratepayers and pool members throughout the country.⁷³ Finally, on the topic of imprudent investment, SIC's small number of subscribers raised concerns at NECA over SIC's decision to

⁷⁰ PacificBusinessNews.com, Sandwich Isles Completes Undersea Cable, <http://pacific.bizjournals.com/pacific/stories/2009/06/22/daily63.html> (last visited August 24, 2009). This article cites to a SIC's statement claiming the new cable "consists of 48 strands of pure glass fiber and that it is the largest in the state, with the bandwidth to carry 2.9 terabits of data per second." NECA believes this cable has the capacity potential to provide broadband services to the entire combined wireline voice customer base in the State of Hawaii. However, SIC currently reports 3,659 working loops. See, Universal Service Administrative Company (USAC), FCC- Quarterly Administrative Filings, 4th Quarter 2015 Appendix HC-05, <http://www.usac.org/about/tools/fcc/filings/2015/q4.aspx> (last visited on April 8, 2016). The FCC reports a total of approximately 471,000 wireline voice subscribers. FCC, Voice Telephone Services Report, State-Level Subscriptions, Supplemental Table 1. (in Thousands) – Hawaii, available at <https://www.fcc.gov/voice-telephone-services-report> (last viewed Apr. 14, 2016), NECA's percentage of this figure (3,659 / 471,000) equals 0.8 percent.

⁷¹ *Docket 19129 Phase II.*

⁷² See text accompanying note 57, *supra*.

⁷³ See Appendix B (attached to this pleading), showing contribution levels that would have to be paid by other pool members to cover SIC's revenue requirement. This contribution to SIC costs also has an impact on Digital Subscriber Line and related NECA pool tariff service rates, which can have an adverse impact on broadband "take" rates in rural areas.

lease the entire cable capacity. These concerns led NECA to investigate whether the leasing of an entire new cable network met the used and useful and prudent expenditure standards.⁷⁴ It appears to NECA that SIC had a number of more reasonable alternatives to meet its transport capacity needs to serve its customers on the HHL given there were two and are now three undersea cable systems serving the Hawaiian Islands. It would have been more reasonable and economical to lease only a portion of the cable from the Paniolo Cable Company (owner of the leased SIC cable).⁷⁵ Alternatively, based on NECA's research it appears a lease from a third party for needed capacity on their respective cables would have been more reasonable and economical.

III. SIC SHOULD NOT BE ALLOWED TO INCLUDE THE LEASE EXPENSES IN NECA REVENUE REQUIREMENT WHEN IT HAS NOT ACTUALLY PAID THE FULL COSTS OF THE LEASE AND THERE IS NO PROSPECT FOR ACTUAL PAYMENT IN SIGHT.

Given that the Bureau in the *Declaratory Ruling* permitted SIC to include in its pool revenue requirement "50 percent of the disputed lease expenses" exclusively on the application of equitable factors, NECA has been following the requirements of that *Ruling*. A further

⁷⁴ The FCC has directed NECA to "implement the access charge system in accordance with Commission rules To justify its tariff filings, NECA must believe in good faith that the data in the filings comply with those rules." *See, Safeguards Order* at ¶ 40. Because NECA has been given the duty to interpret the Commission's rules on behalf of those companies choosing to participate in the NECA pool, we must be mindful that the "data that each LEC reports to NECA affects not only its own earnings, but also the earnings of other carriers." Reporting the cost(s) of this lease into the pools could have a dramatic effect on the other pool participants. The Commission itself has declared that, "it would be unfair to those participants that implement NECA's rule interpretations to allow more aggressive participants to increase their revenue at the group's expense." An analysis done by NECA in 2009 showed that the proposal submitted by SIC for the then-coming upcoming annual tariff filing to include its entire lease costs in the traffic sensitive pool posed major concerns relative to the impact on rate levels, as well as to the contribution flow from the pool.

⁷⁵ SIC now has an exclusive lease for the largest undersea cable in Hawaii while serving only 0.8 percent of Hawaii wireline voice customers.

dispute over the application of the Ruling arose when NECA discovered that SIC was in fact not actually paying the full costs of the Paniolo system lease, described as follows.

A. SIC's Nonpayment of Lease Expenses

In accordance with NECA's routine procedures, it reviewed a 2014 cost study and support materials covering the years 2012 and 2013, performed by SIC's outside auditor, and submitted to NECA.⁷⁶ From public documents⁷⁷ and a review of submitted cost information, it appeared that SIC was including expenses associated with the lease of the Paniolo cable system in a manner which could be inconsistent with both the requirements of the *Declaratory Ruling* as well as generally accepted accounting principles ("GAAP"). The NECA traffic sensitive pool is currently paying SIC amounts for the Paniolo cable system expenses as if the lease payments were actually made.

However, SIC is only paying a portion of the lease obligations and it is only using a portion of the pool funds provided pursuant to the *Ruling* to pay those Paniolo cable system expenses. In its review, NECA found SIC **

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**. SIC's cost study for 2012

indicates that the company had lease payments of \$**CONF** for the Paniolo cable system, but its financial statements show SIC **

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⁷⁶ The Commission has declared that NECA review of cost studies is critical. *Safeguards to Improve the Administration of the Interstate Access Tariff and Revenue Distribution Processes*, CC Docket No. 93-6, Report & Order & Order to Show Cause, 10 FCC Rcd. 6243, ¶ 64 (1995).

⁷⁷ SIC is apparently making only some of the lease payments. See note 76, *infra*.

⁷⁸ Based on SIC's reported lease expenses for 2012, SIC's traffic sensitive NECA pool revenue requirement for the lease was approximately \$**CNF**. However, if SIC's data is trued up to reflect its actual lease payments of \$**CNF** in line with NECA's interpretation of the *Ruling*, and using switched access amounts frozen at 2011 levels for the second half of the year, SIC's traffic sensitive pool revenue requirement for the lease would be approximately \$**CNF**.

SIC's cost study for 2013 indicates the company had lease payments of \$** CONFIDENTIAL

. ⁷⁹ Finally, in 2014, SIC records indicate lease payments of \$ CONFIDENTIAL

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liability/accounts payable. However, the actual payment ** CONFIDENTIAL

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B. NECA's Interpretation of the *Declaratory Ruling*

From a reading of the *Ruling*, NECA believed that the intent of the FCC's *Ruling* was to ensure that certain cable lease expenses incurred by SIC be recovered from the NECA pool. There was no specific discussion in the *Ruling*, however, of the issue of actually paying, in cash, the "lease expenses subject to dispute."

NECA believed its position was supported through its understanding of GAAP requirements, in order for an expense to be a properly booked as a current accrued liability, the company must intend to pay such liability within the normal business cycle.⁸¹ If actual payment is not reasonably expected within the normal business cycle, designation as a current liability/account payable is inconsistent with accounting principles. At the time the Clarification

⁷⁹ As with 2012, SIC's reported lease expenses for 2013 do not reflect its actual payments towards the Paniolo Lease despite the fact that SIC's traffic sensitive NECA pool revenue requirement explicitly to be used for the lease was approximately \$**CONF**. If the actual lease payments of only \$**CONF** for 2013 were used, with the switched access amounts frozen at 2011 levels, SIC's traffic sensitive pool revenue requirement for the lease would be approximately \$**CNF**.

⁸⁰ Consistent with notes 77 and 78, SIC's traffic sensitive 2014 NECA pool revenue requirement explicitly to be used for the lease was approximately \$**CNF**. If the actual Lease payments of \$***** for 2014 were used, with the switched access amounts frozen at 2011 levels, SIC's traffic sensitive pool revenue requirement for the lease would be approximately \$**CNF**.

⁸¹ NECA Clarification Petition at 6-7.

Petition was filed, SIC was not paying this accrued liability within the normal business cycle and in fact ** CONFIDENTIAL **. NECA has no more current SIC cost support data regarding any actual lease payments. The Clarification Petition also supported its position through FCC rules and precedent.⁸² Therefore, treating the lease obligations as a current expense accrual/accounts payable does not appear to be appropriate.

Paniolo relies on SIC's payments in order to pay DeutscheBank, which funded the cable costs.⁸³ SIC has told NECA that it is ** CONFIDENTIAL

** but has not indicated (1) when the amounts will actually be paid, or (2) whether actual payment of past underpayments will be required.⁸⁴ SIC does not specify a date on which ** CONFIDENTIAL **, and close to one year has transpired since that statement was made.⁸⁵

SIC opposed NECA's Petition, and argued that its accrual accounting fully complied with the terms of the *Declaratory Ruling*.⁸⁶ In its Opposition, SIC did not indicate when it would actually pay the accounting entries or if in fact it ever would. This Clarification Petition record

⁸² NECA Clarification Petition at 7-10.

⁸³ DeutscheBank sued SIC and its related insurance company for nonpayment of the lease, and the complaint revealed that SIC was not paying its full lease obligations, and thus had "defaulted" on the lease. Complaint, *Deutsche Bank Trust Co. Americas v. Ho'opa'a Insurance Corp. & Sandwich Isles Communications, Inc.*, Civ No. CV1400033-JMS-RLP, ¶¶ 32-35 (D. Ct. Haw., dated Jan. 24, 2014). The status of this litigation is unknown.

⁸⁴ NECA Clarification Petition, Exhibit 2.

⁸⁵ SIC representations that its expense treatment of lease obligations is reasonable are questionable given that ** CONFIDENTIAL

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CONFIDENTIAL **. See AKT Auditor's Report, Financial Statements and RUS Letters, Years Ended Dec. 31, 2013 and 2012, (May 7, 2014), NECA Clarification Petition, Exhibit 3.

⁸⁶ SIC Opposition at ii.

is complete and ripe for decision. NECA pool members (and thus their respective ratepayers for special access services, including broadband) continue to fund SIC's accounting entries, which are not necessary to compensate investors to the extent that they are not actually paying Paniolo cable system lease costs.

IV. CONCLUSION

NECA's legal position continues to be that, based both on the facts that existed prior to the *Declaratory Ruling*, and today, the cost and the capacity of the Paniolo cable system are far in excess of what is reasonably required to serve SIC broadband customers from 2010 through the near future. Although NECA does not take any position on the equitable factors adopted in the Bureau's Declaratory Ruling, the application of the equitable factors should be reconsidered in light of the actual facts which have taken place since the *Ruling* was issued, including SIC's current provision of DSL service and its failure to actually pay the entire Paniolo system lease costs. NECA urges the Commission to promptly resolve not only the pending challenges to the *Declaratory Ruling*, but also NECA's Clarification Petition.

Respectfully submitted,

By: /s/ Gregory J. Vogt

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April 28, 2016

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Counsel for National Exchange Carrier Association, Inc.

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)	
)	
Sandwich Isles Communications, Inc.)	WC Docket No. 09-133
Petition for Declaratory Ruling)	


DECLARATION OF JAMES W. FRAME

I, James W. Frame, am Vice President of Operations for the National Exchange Carrier Association, Inc. ("NECA"). I have held my current position since October 1, 1997. I hereby declare as follows:

1. I am familiar with the Declaratory Ruling issued by the Wireline Competition Bureau ("WCB") of the Federal Communications Commission ("FCC") issued in *Sandwich Isles Communications, Inc.*, 25 FCC Rcd. 13647 (WCB 2010), *pet. for recon. and app. for rev. pending* ("Declaratory Ruling" or "Ruling"), as well as the implementation steps that NECA has taken in order to comply with that Order.

2. I am familiar with the National Exchange Carrier Association, Inc., Petition for Clarification and-or Declaratory Ruling, WC Docket No. 09-133 (dated Feb. 6, 2015) ("Petition"), as well as the pleadings that have been filed with respect to that Petition.

3. I have reviewed NECA's April 28, 2016 comments, to which this Declaration is attached. I declare under penalty of perjury that these facts are true and correct to the best of my knowledge, information and belief.


James W. Frame

Dated: April 28, 2016

APPENDIX A

This document contains privileged and confidential information and has therefore been withheld from the public copy of this document pursuant to Federal Communications Commission Protective Order entered in WC Docket No. 09-133.

APPENDIX B

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